



FINANCIAL STATEMENTS

June 30, 2006



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
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JAMES K. POLK STATE OFFICE BUILDING
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Independent Auditor's Report

September 29, 2006

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the accompanying statements of net assets of the Tennessee Housing Development Agency, a component unit of the State of Tennessee, as of June 30, 2006, and June 30, 2005, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the agency's management. Our responsibility is to express an opinion on these financial statements, based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include serving as a member of the board of directors of the Tennessee Housing Development Agency; approving accounting policies of the state as prepared by the state's Department of Finance and Administration; approving certain state contracts; participating in the

The Honorable John G. Morgan
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negotiation and procurement of services for the state; and providing support staff to the bond finance committee of the Tennessee Housing Development Agency.


In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Tennessee Housing Development Agency as of June 30, 2006, and June 30, 2005, and the changes in its financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis section is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements. The accompanying supplementary information, following the notes to the financial statements, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 29, 2006, on our consideration of the agency's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

A handwritten signature in black ink, reading "Arthur A. Hayes, Jr." with a stylized flourish at the end.

Arthur A. Hayes, Jr., CPA
Director

AAH/tlh

TENNESSEE HOUSING DEVELOPMENT AGENCY
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2006 AND JUNE 30, 2005

This section of the Tennessee Housing Development Agency's (Agency) annual financial statements presents management's discussion and analysis of the financial performance of the Agency for the years ended June 30, 2006 and June 30, 2005. This information is being presented to provide additional information regarding the activities of the Agency and to meet the reporting and disclosure requirements of the Governmental Accounting Standards Board Statement Number 34. *Basic Financial Statements -- and Management's Discussion and Analysis -- for State and Local Governments*. This analysis should be read in conjunction with the Agency's financial statements, which follow this section.

INTRODUCTION – THE TENNESSEE HOUSING DEVELOPMENT AGENCY

The Tennessee Housing Development Agency was established by the Tennessee General Assembly in 1973,

In order to promote the production of more affordable new housing units for very low, low and moderate income individuals and families in the state, to promote the preservation and rehabilitation of existing housing units for such persons, and to bring greater stability to the residential construction industry and related industries so as to assure a steady flow of production of new housing units... (*Tennessee Code Annotated* 13-23-102)

The mission of the Agency is to be the lead State Agency promoting sound and affordable housing for people who need help. THDA's goal is to provide housing assistance to those in need, and to do so by offering a variety of programs to serve various types of need. One of the primary ways the Agency assist people is by offering mortgages for first-time homebuyers at below conventional market interest rates. In 2002, the Agency celebrated the financing of the 80,000th homebuyer. The Agency also serves as the master servicer for all active mortgages funded by THDA. In addition to helping homebuyers, THDA administers the federal Section 8 rental assistance programs, including both tenant- and project-based assistance. THDA also administers grant programs, awarded on a competitive annual cycle, for rehabilitation and new construction of owner-occupied units and small rental projects. THDA is also involved in the development and rehabilitation of multifamily rental housing for low-income families by administering the federal Low-Income Housing Tax Credit, which is a competitive process, and by setting aside a portion of Bond Authority to be allocated to local authorities for specific multifamily developments.

As established by statute, "The agency shall have a board of directors which shall be responsible for carrying out the powers given to the agency. . ." (*Tennessee Code Annotated* 13-23-105)

OVERVIEW OF THE FINANCIAL STATEMENTS

The basic financial statements include statements of net assets, statements of revenues, expenses and changes in net assets, statements of cash flows, as well as notes to the financial statements. The statements of net assets provide financial information on the overall financial

TENNESSEE HOUSING DEVELOPMENT AGENCY
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONT.)
JUNE 30, 2006 AND JUNE 30, 2005

position of the Agency at each year end. The statements of revenues, expenses and changes in net assets summarize the results of operations over the course of each fiscal year. The statements of cash flows provide relevant information about the Agency's cash receipts and cash payments during each fiscal year. The notes to the financial statements provide useful information regarding the Agency's significant accounting policies, significant account balances and activities, certain material risks, obligations, commitments, contingencies and subsequent events. The Agency's financial statements are presented using the accrual basis of accounting and the flow of economic resources measurement focus. In addition to the basic financial statements, other supplementary information is also included.

The Agency is also considered a "component unit" for the State of Tennessee, and therefore, is reported in the State of Tennessee's government-wide *Comprehensive Annual Financial Report*. This report may be viewed in PDF format at <http://tennessee.gov/finance/act/cafr.html>.

FINANCIAL HIGHLIGHTS

Year Ended June 30, 2006

- Total assets increased by \$91.7 million, or 4.1 %.
- Total liabilities increased by \$90.8 million, or 5.0%.
- Total assets exceeded total liabilities by \$433.3 million. This is an increase of \$0.8 million, or 0.2% from fiscal year 2005.
- Cash and cash equivalents decreased \$19.8 million, or 4.5%.
- Total investments increased \$30.7 million, or 8.7%.
- Bonds and notes payable increased \$85.5 million, or 4.9%.
- The Agency originated \$283.0 million in new loans, which is an increase of \$67.7 million, or 31.4% from the prior year.

Year Ended June 30, 2005

- Total assets increased by \$11.8 million, or .5 %.
- Total liabilities decreased \$22.6 million, or 1.2%.
- Total assets exceeded total liabilities by \$432.5 million. This is an increase of \$34.4 million, or 8.6%, from fiscal year 2004.
- Cash and cash equivalents increased \$68.2 million, or 18.1%.
- Total investments decreased \$27 million, or 7.1%.
- Bonds and notes payable decreased \$17.2 million, or 1%.

TENNESSEE HOUSING DEVELOPMENT AGENCY
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONT.)
JUNE 30, 2006 AND JUNE 30, 2005

- The Agency originated \$215.3 million in new loans, which is a decrease of \$57.9 million, or 21.2% from the prior year.

FINANCIAL ANALYSIS OF THE AGENCY

Net Assets. The following table focuses on the changes in net assets between fiscal years (expressed in thousands):

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Current assets	\$ 525,616	\$ 508,384	\$ 459,245
Capital assets	60	16	16
Other noncurrent assets	<u>1,802,256</u>	<u>1,727,813</u>	<u>1,765,131</u>
Total assets	<u>2,327,932</u>	<u>2,236,213</u>	<u>2,224,392</u>
Current liabilities	159,520	355,537	138,620
Noncurrent liabilities	<u>1,735,061</u>	<u>1,448,152</u>	<u>1,687,697</u>
Total liabilities	<u>1,894,581</u>	<u>1,803,689</u>	<u>1,826,317</u>
Invested in capital assets	60	16	16
Restricted net assets	428,757	425,198	388,913
Unrestricted net assets	<u>4,534</u>	<u>7,310</u>	<u>9,146</u>
Total net assets	<u>\$ 433,351</u>	<u>\$ 432,524</u>	<u>\$ 398,075</u>

2006 to 2005

- The Agency's total net assets increased \$0.8 million, or .2%, from \$432.5 million at June 30, 2005 to \$433.3 million at June 30, 2006. This resulted from normal Agency operations.
- Mortgage loans receivable increased \$79.1 million, or 5.7%, from \$1,391.7 million at June 30, 2005 to \$1,470.8 million at June 30, 2006. The Agency initiated a new marketing and outreach program for our single-family mortgage loan products. As a result, the Agency originated mortgage loans in 2006 totaling \$283.0 million, which was \$67.7 million, or 31.4% more than the \$215.3 million originated in fiscal year 2005. In addition, prepayments for fiscal year 2006 were \$172.3 million; which was \$17.8 million less than the \$190.1 million received in 2005.

TENNESSEE HOUSING DEVELOPMENT AGENCY
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONT.)
JUNE 30, 2006 AND JUNE 30, 2005

- Total liabilities increased \$90.9 million, or 5.0%, from \$1,803.7 million at June 30, 2005 to \$1,894.6 million at June 30, 2006. The increase is primarily due to an increase in the amount of bonds and notes issued.

2005 to 2004

- The Agency's total net assets increased \$34.4 million, or 8.6%, from \$398.1 million at June 30, 2004 to \$432.5 million at June 30, 2005. This primarily resulted from the increase in the fair value of investments.
- Mortgage loans receivable decreased \$25.3 million, or 1.8%, from \$1,417.0 million at June 30, 2004 to \$1,391.7 million at June 30, 2005. The decrease resulted from loan prepayments exceeding loan originations.
- Total liabilities decreased \$22.6 million, or 1.2%, from \$1,826.3 million at June 30, 2004 to \$1,803.7 million at June 30, 2005. The decrease is primarily due to the retirement of debt.

Changes in Net Assets. The following table summarizes the changes in revenues, expenses and changes in net assets between fiscal years (expressed in thousands):

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Operating revenues			
Mortgage interest income	\$ 87,118	\$ 88,438	\$ 93,763
Investment income (loss)	14,024	39,007	(67)
Other	13,096	13,035	12,174
Total operating revenues	<u>114,238</u>	<u>140,480</u>	<u>105,870</u>
Operating expenses			
Interest expense	86,566	81,294	83,326
Other	22,102	20,660	24,005
Total operating expenses	<u>108,668</u>	<u>101,954</u>	<u>107,331</u>
Operating income (loss)	<u>5,570</u>	<u>38,526</u>	<u>(1,461)</u>
Nonoperating revenues (expenses)			
Grant revenues	162,137	151,630	143,630
Grant expenses	(166,880)	(155,707)	(149,810)
Total nonoperating revenues (expenses)	<u>(4,743)</u>	<u>(4,077)</u>	<u>(6,180)</u>
Changes in net assets	<u>\$ 827</u>	<u>\$ 34,449</u>	<u>\$ (7,641)</u>

TENNESSEE HOUSING DEVELOPMENT AGENCY
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONT.)
JUNE 30, 2006 AND JUNE 30, 2005

2006 to 2005

For the year ended June 30, 2006, total operating revenues decreased \$26.3 million from \$140.5 million for the year ended June 30, 2005 to \$114.2 million for the year ended June 30, 2006. The primary reason for this decrease is that investment income decreased \$25 million, from \$39 million in 2005 to \$14 million in 2006. This decrease is due to a net decrease in the fair value of investments of \$9.6 million in 2006 (as compared to a net increase of \$18.2 million in 2005) as well as interest rates remaining at relatively low historical rates.

For the year ended June 30, 2006, total operating expenses increased \$6.7 million, or 6.6%, from \$101.9 million in 2005 to \$108.6 million in 2006. This increase is primarily due to an increase in interest expense of \$5.3 million, from \$81.3 million in 2005 to \$86.6 million in 2006. This increase occurred due to an increase in bonds issued during the current year.

While the total net assets for fiscal year 2006 increased \$827 thousand from the previous year, the non-monetary accretion of deep discount bonds and the change in the fair value of investments accounted for a net decrease of \$20.0 million. When considered without these non-monetary components, net assets would have increased \$20.8 million.

2005 to 2004

For the year ended June 30, 2005, total operating revenues increased \$34.6 million from \$105.9 million for the year ended June 30, 2004, to \$140.5 million for the year ended June 30, 2005. The primary reasons for this increase are as follows:

- Mortgage interest income decreased \$5.4 million, or 5.7%, from \$93.8 million in 2004 to \$88.4 million in 2005. This is due to mortgage loan prepayments of higher interest loans, as well as new loans originated at lower interest rates.
- Investment income increased \$39 million, from a net loss of \$67,000 in 2004 to a net gain of \$39 million in 2005. This increase is primarily due to a net increase in the fair value of investments of \$18.2 million in 2005 as compared to a net decrease of \$22.2 million in 2004. In addition, new investments are yielding low interest rates due to current market conditions.

For the year ended June 30, 2005, total operating expenses decreased \$5.4 million, or 5%, from \$107.3 million in 2004 to \$101.9 million in 2005. This decrease is primarily due to a decrease in interest expense of \$2.0 million, from \$83.3 million in 2004 to \$81.3 million in 2005. This decrease occurred as a result of the Agency continuing to use mortgage loan prepayments to call higher-interest bonds.

While the total net assets for fiscal year 2005 increased \$34.4 million from the previous year, the non-monetary accretion of deep discount bonds and the change in the fair value of

TENNESSEE HOUSING DEVELOPMENT AGENCY
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONT.)
JUNE 30, 2006 AND JUNE 30, 2005

investments contributed \$12.4 million toward this increase. When considered without these non-monetary components, net assets increased \$21.5 million.

CASH FLOWS

Cash flows for fiscal years ending 2006, 2005, and 2004 were as follows (expressed in thousands):

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Cash and cash equivalents, July 1	\$ 444,586	\$ 376,297	\$ 366,383
Net cash provided (used) by operating activities	(4,102)	100,663	97,401
Net cash provided (used) by non-capital financing activities	1,194	(98,539)	(157,673)
Net cash used by capital and related financing activities	(60)	(5)	(16)
Net cash provided (used) by investing activities	(16,828)	66,170	70,202
Net increase (decrease) in cash and cash equivalents	<u>(19,796)</u>	<u>68,289</u>	<u>9,914</u>
Cash and cash equivalents, June 30	<u>\$ 424,790</u>	<u>\$ 444,586</u>	<u>\$ 376,297</u>

For the year ended June 30, 2006, the Agency's net cash decreased \$19.8 million, as compared to positive cash flows in each of the prior two fiscal years. One major component of the Agency's cash flows is the amount of cash provided by, or used by, investing activities. As noted above, the Agency's investment activities in the current fiscal year resulted in a "use" of cash, whereas the previous two years resulted in a "source" of cash.

Another major component in the Agency's cash flows is the difference between mortgage loan originations (a use of operating cash) and mortgage loan prepayments (a source of operating cash). During the current fiscal year, the Agency initiated a marketing and outreach program that resulted in a rise in mortgage loan originations, which was a use of cash. The amounts of mortgage loan originations and prepayments are depicted in the following chart:

TENNESSEE HOUSING DEVELOPMENT AGENCY
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONT.)
JUNE 30, 2006 AND JUNE 30, 2005

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Mortgage Loan Prepayments (Source of cash)	\$ 172,269	\$ 190,060	\$ 249,169
Mortgage Loan Originations (Use of cash)	(283,007)	(215,315)	(273,234)
Difference	<u>\$(110,738)</u>	<u>\$ (25,255)</u>	<u>\$ (24,065)</u>

DEBT ACTIVITY

Bonds and notes outstanding at June 30 were as follows (expressed in thousands):

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Bonds payable	\$1,568,472	\$1,433,430	\$1,489,299
Notes payable	<u>262,395</u>	<u>311,900</u>	<u>273,240</u>
Total bonds and notes payable	<u>\$1,830,867</u>	<u>\$1,745,330</u>	<u>\$1,762,539</u>

Year Ended June 30, 2006

Total bonds and notes payable increased \$85.5 million, or 4.9%, due primarily to an increase in the origination of long-term bonds during the fiscal year. During 2006, the Agency issued debt totaling \$545 million, with activity arising from three bond issues totaling \$306.5 million and two draws under the single family mortgage note program totaling \$238.5 million. The increase in mortgage loan production, which requires funds, resulted in the increase in long-term debt originations.

Year Ended June 30, 2005

Total bonds and notes payable decreased \$17.2 million, or 1%, due primarily to retirement of debt. During the fiscal year, the Agency issued debt totaling \$319 million, with activity arising from two bond issues totaling \$203.5 million and three draws under the single family mortgage note program totaling \$115.5 million.

Note Authority

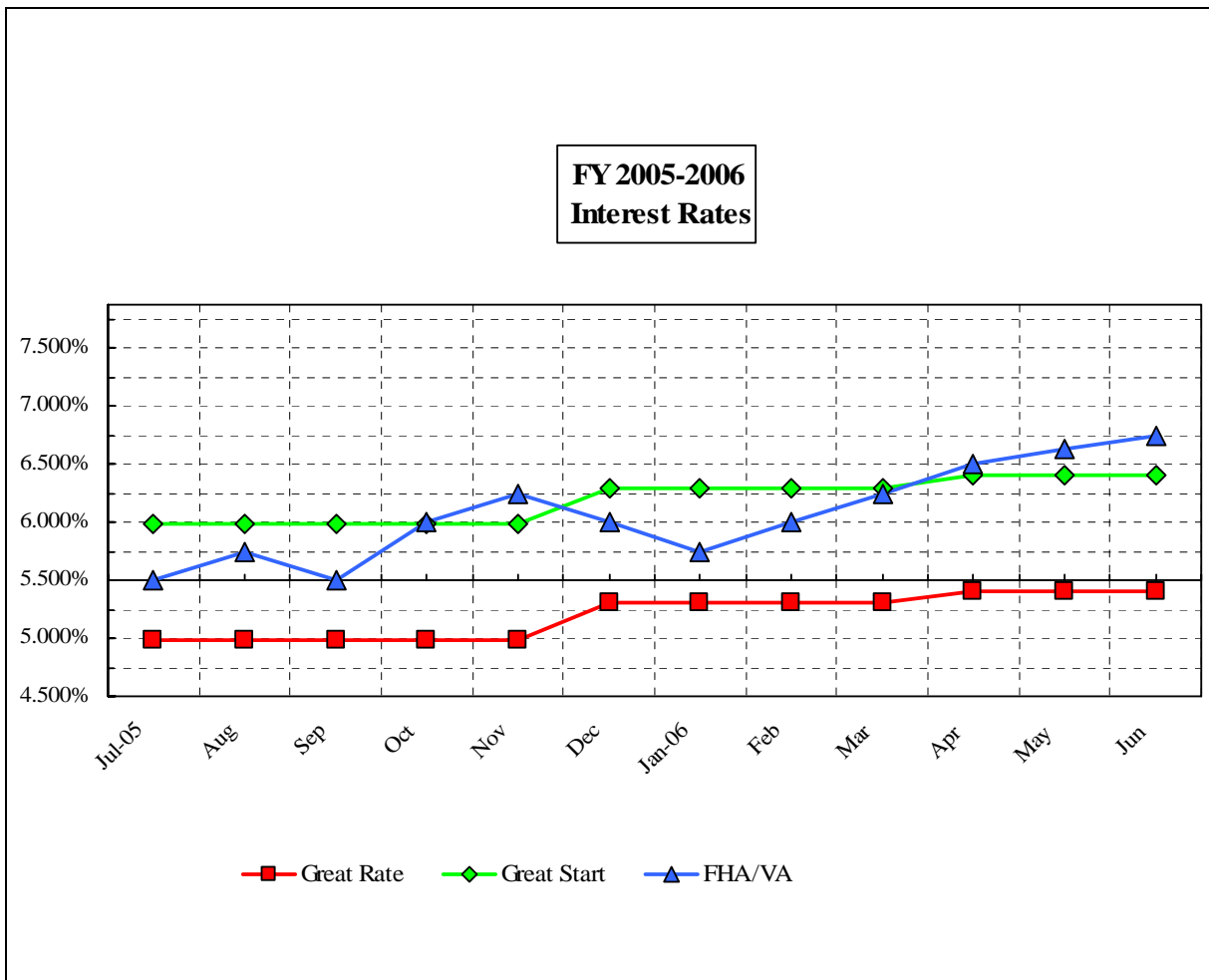
On March 18, 2004, the Agency's board of directors authorized the issuance of Single Family Mortgage Note, Series 2004CN-1. This \$450 million drawdown note with a maturity of up to three years closed on August 31, 2004.

TENNESSEE HOUSING DEVELOPMENT AGENCY
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONT.)
JUNE 30, 2006 AND JUNE 30, 2005

Additional information on the Agency's long-term debt is presented in Note 4 to the financial statements.

ECONOMIC FACTORS

Fiscal Year 2006 saw a slight rebound in mortgage loan rates. The Great Rate mortgage program offers a below market interest rate loan secured by a first mortgage. The Great Start program offers a loan at a slightly higher interest rate, secured by a first mortgage, but offers down payment and closing cost assistance. The following charts depict the Agency's mortgage loan rates as compared to the average FHA/VA loan rates during Fiscal Year 2006:

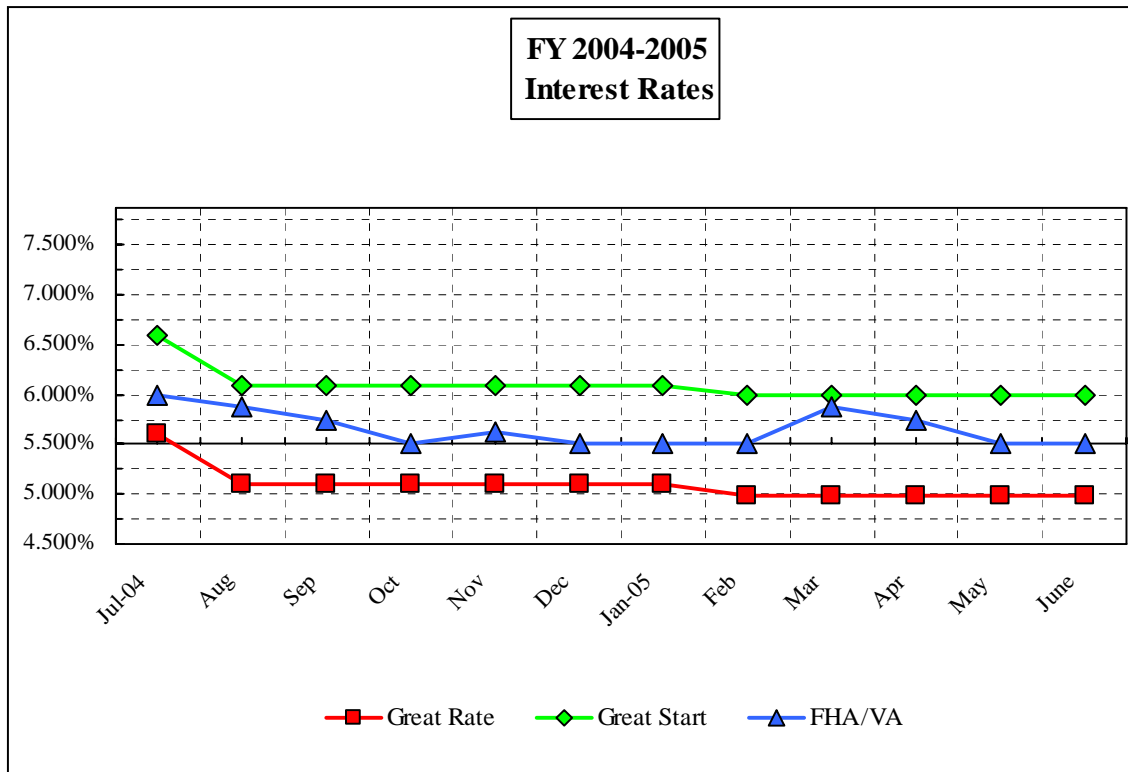


As noted above, the "Great Rate" at the end of the fiscal year was approximately 125 basis points below the average FHA/VA rates, thus making our rates very attractive to the market place. Conversely, the "Great Rate" as of the beginning of the fiscal year was only 50 basis

TENNESSEE HOUSING DEVELOPMENT AGENCY
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONT.)
JUNE 30, 2006 AND JUNE 30, 2005

points below the average FHA/VA rates. Historically, THDA's mortgage loan originations increase as the spread between our rates and the market rates increase. During the last half of the 2006 fiscal year, this spread began increasing. This increase, along with an increased marketing and outreach program, resulted in a higher production of mortgage loans. We anticipate that this spread will continue to be relatively wide during the early months of Fiscal Year 2007.

For comparison purposes, the chart of THDA rates, compared with the comparable FHA/VA average rates, for Fiscal Year 2005 is depicted below:



TENNESSEE HOUSING DEVELOPMENT AGENCY
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONT.)
JUNE 30, 2006 AND JUNE 30, 2005

The Agency continued to use the proceeds from mortgage loan prepayments to call its bond debt. However, the decrease in the amount of prepayments, coupled with a continued increase in market investment rates, reduced the frequency and quantity of bond redemptions.

In accordance with the Agency's investment policy, the Agency typically invests in short-term collateralized repurchase agreements, as well as short-term and long-term fixed-rate debt securities from federal agencies. As a bench-mark, the Agency uses the one, three, and five year Constant Maturity Treasury (CMT) rates as established by the United States Treasury. The following tables depict these rates for fiscal years 2006 and 2005:

For the Fiscal Year Ending June 30, 2006

<u>Month</u>	<u>1yr CMT</u>	<u>3yr CMT</u>	<u>5yr CMT</u>
June 30, 2006	5.16%	5.09%	5.07%
May 31, 2006	5.00%	4.97%	5.00%
April 30, 2006	4.90%	4.89%	4.90%
March 31, 2006	4.77%	4.74%	4.72%
February 28, 2006	4.68%	4.64%	4.57%
January 31, 2006	4.45%	4.35%	4.35%
December 31, 2005	4.35%	4.39%	4.39%
November 30, 2005	4.33%	4.43%	4.45%
October 31, 2005	4.18%	4.29%	4.33%
September 30, 2005	3.85%	3.96%	4.01%
August 31, 2005	3.87%	4.08%	4.12%
July 31, 2005	3.64%	3.91%	3.98%

For the Fiscal Year Ending June 30, 2005

<u>Month</u>	<u>1yr CMT</u>	<u>3yr CMT</u>	<u>5yr CMT</u>
June 30, 2005	3.36%	3.69%	3.77%
May 31, 2005	3.33%	3.72%	3.85%
April 30, 2005	3.32%	3.79%	4.00%
March 31, 2005	3.30%	3.91%	4.17%
February 28, 2005	3.03%	3.54%	3.77%
January 31, 2005	2.86%	3.39%	3.71%
December 31, 2004	2.67%	3.21%	3.60%
November 30, 2004	2.50%	3.09%	3.53%
October 31, 2004	2.23%	2.85%	3.35%
September 30, 2004	2.12%	2.83%	3.36%
August 31, 2004	2.02%	2.88%	3.47%
July 31, 2004	2.10%	3.05%	3.69%

While these benchmarks continued their rebound in fiscal year 2006 from the historically low rates as noted in the prior few years, the benchmarks remain below the median rates noted over the past two decades. Currently, the investments yields are often below the related bond yields, which results in negative arbitrage. The Agency monitors prepayments and bond

TENNESSEE HOUSING DEVELOPMENT AGENCY
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONT.)
JUNE 30, 2006 AND JUNE 30, 2005

investment yields, and seeks to reduce negative arbitrage by calling bonds with the funds from prepayments.

CONTACTING THDA's FINANCIAL MANAGEMENT

This financial report is designed to provide the Agency's stakeholders with a general overview of the Agency's finances and to show accountability for the funds that it receives, invests, and expends. If you have questions about this report, or need additional financial information, contact Trent Ridley, Chief Financial Officer at (615) 532-9180 or via e-mail at Trent.Ridley@state.tn.us.

TENNESSEE HOUSING DEVELOPMENT AGENCY
STATEMENTS OF NET ASSETS
JUNE 30, 2006 AND JUNE 30, 2005
(Expressed in Thousands)

	2006	2005
ASSETS		
Current assets:		
Cash and cash equivalents (Note 2)	\$ 424,616	\$ 444,096
Investments (Note 2)	34,370	-
Receivables:		
Accounts	10,431	12,054
Interest	11,612	12,006
First mortgage loans	34,269	32,939
Due from federal government	10,318	7,289
Total current assets	525,616	508,384
Noncurrent assets:		
Restricted assets:		
Cash and cash equivalents (Note 2)	174	490
Investments (Note 2)	176,393	186,856
Investment interest receivable	2,475	2,367
Investments (Note 2)	172,249	165,474
First mortgage loans receivable	1,436,524	1,358,785
Deferred charges	11,619	11,124
Advance to local government	2,812	2,707
Other receivables	10	10
Capital assets:		
Furniture and equipment	153	93
Less accumulated depreciation	(93)	(77)
Total noncurrent assets	1,802,316	1,727,829
Total assets	2,327,932	2,236,213
LIABILITIES		
Current liabilities:		
Checks / warrants / wires payable (Note 3)	5,855	1,764
Accounts payable	1,183	746
Accrued payroll and related liabilities	323	279
Compensated absences	285	313
Due to primary government	84	42
Interest payable	37,917	35,315
Escrow deposits	969	1,485
Prepayments on mortgage loans	1,379	1,268
Notes payable (Note 4)	-	235,595
Bonds payable (Note 4)	111,525	78,730
Total current liabilities	159,520	355,537
Noncurrent liabilities:		
Notes payable (Note 4)	262,395	76,305
Bonds payable (Note 4)	1,456,947	1,354,700
Compensated absences	297	326
Escrow deposits	14,355	13,875
Arbitrage rebate payable	848	2,687
Deferred revenue	219	259
Total noncurrent liabilities	1,735,061	1,448,152
Total liabilities	1,894,581	1,803,689
NET ASSETS		
Invested in capital assets	60	16
Restricted for single family bond programs (Note 5)	425,218	421,584
Restricted for grant programs (Note 5)	385	460
Restricted for Homebuyers Revolving Loan Program (Note 5)	3,154	3,154
Unrestricted (Note 7)	4,534	7,310
Total net assets	\$ 433,351	\$ 432,524

The Notes to the Financial Statements are an integral part of this statement.

TENNESSEE HOUSING DEVELOPMENT AGENCY
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2006 AND JUNE 30, 2005
(Expressed in Thousands)

	<u>2006</u>	<u>2005</u>
OPERATING REVENUES		
Mortgage interest income	\$ 87,118	\$ 88,438
Investment income:		
Interest	23,626	20,779
Net increase (decrease) in the fair value of investments	(9,602)	18,228
Federal grant administration fees	9,903	9,861
Fees and other income	<u>3,193</u>	<u>3,174</u>
Total operating revenues	<u>114,238</u>	<u>140,480</u>
OPERATING EXPENSES		
Salaries and benefits	10,121	9,778
Contractual services	1,766	1,707
Materials and supplies	425	460
Rentals and insurance	1,083	996
Other administrative expenses	453	371
Other program expenses	2,547	1,566
Interest expense	86,566	81,294
Mortgage service fees	5,163	5,074
Issuance costs	527	703
Depreciation	<u>17</u>	<u>5</u>
Total operating expenses	<u>108,668</u>	<u>101,954</u>
Operating income	<u>5,570</u>	<u>38,526</u>
NONOPERATING REVENUES (EXPENSES)		
Federal grants revenue	162,137	151,630
Federal grants expenses	(162,137)	(151,630)
Local grants expenses	<u>(4,743)</u>	<u>(4,077)</u>
Total nonoperating revenues (expenses)	<u>(4,743)</u>	<u>(4,077)</u>
Change in net assets	<u>827</u>	<u>34,449</u>
Total net assets, July 1	<u>432,524</u>	<u>398,075</u>
Total net assets, June 30	<u>\$ 433,351</u>	<u>\$ 432,524</u>

The Notes to the Financial Statements are an integral part of this statement.

TENNESSEE HOUSING DEVELOPMENT AGENCY
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2006 AND JUNE 30, 2005
(Expressed in Thousands)

	2006	2005
Cash flows from operating activities:		
Receipts from customers	\$ 293,066	\$ 329,852
Receipts from federal government	5,502	6,079
Other miscellaneous receipts	3,193	3,174
Acquisition of mortgage loans	(283,007)	(215,315)
Payments to service mortgages	(5,163)	(5,074)
Payments to suppliers	(5,311)	(4,625)
Payments to federal government	(1,927)	(3,423)
Payments to employees	(10,455)	(10,005)
Net cash provided (used) by operating activities	(4,102)	100,663
Cash flows from non-capital financing activities:		
Operating grants received	163,509	158,188
Negative cash balance implicitly financed	4,091	769
Proceeds from sale of bonds	306,515	203,534
Proceeds from issuance of notes	238,455	115,490
Operating grants paid	(166,629)	(155,889)
Call premium paid	-	(175)
Cost of issuance paid	(2,283)	(1,698)
Principal payments	(460,854)	(339,256)
Interest paid	(81,610)	(79,502)
Net cash provided (used) by non-capital financing activities	1,194	(98,539)
Cash flows from capital and related financing activities:		
Purchases of capital assets	(60)	(5)
Net cash used by capital and related financing activities	(60)	(5)
Cash flows from investing activities:		
Proceeds from sales and maturities of investments	60,619	57,150
Purchases of investments	(113,448)	(18,366)
Investment interest received	36,001	27,386
Net cash provided (used) by investing activities	(16,828)	66,170
Net increase (decrease) in cash and cash equivalents	(19,796)	68,289
Cash and cash equivalents, July 1	444,586	376,297
Cash and cash equivalents, June 30	\$ 424,790	\$ 444,586

(continued)

TENNESSEE HOUSING DEVELOPMENT AGENCY
STATEMENTS OF CASH FLOWS (cont.)
FOR THE YEARS ENDED JUNE 30, 2006 AND JUNE 30, 2005
(Expressed in Thousands)

	<u>2006</u>	<u>2005</u>
Reconciliation of operating income to net cash provided (used) by operating activities:		
Operating income	\$ <u>5,570</u>	\$ <u>38,526</u>
Adjustments to reconcile operating income to net cash provided (used) by operating activities:		
Depreciation and amortization	544	708
Changes in assets and liabilities:		
(Increase) decrease in accounts receivable	1,623	(283)
Decrease in mortgage interest receivable	456	1,294
(Increase) decrease in first mortgage loans receivable	(79,174)	25,205
(Increase) in due from federal government	(4,401)	(3,782)
Decrease in deferred charges	327	607
Increase (decrease) in accounts payable	262	(456)
Increase (decrease) in accrued payroll / compensated absences	(13)	68
Increase in due to primary government	41	-
(Decrease) in deferred revenue	(40)	(88)
(Decrease) in arbitrage rebate liability	(1,839)	(3,423)
Investment (income) included as operating revenue	(14,024)	(39,007)
Interest expense included as operating expense	<u>86,566</u>	<u>81,294</u>
Total adjustments	<u>(9,672)</u>	<u>62,137</u>
Net cash provided (used) by operating activities	\$ <u>(4,102)</u>	\$ <u>100,663</u>
Noncash investing, capital, and financing activities:		
Accretion of deep discount bonds	\$ 1,442	\$ 1,957
Increase (decrease) in fair value of investments	<u>(21,450)</u>	<u>10,400</u>
Total noncash investing, capital, and financing activities	\$ <u>(20,008)</u>	\$ <u>12,357</u>

The Notes to the Financial Statements are an integral part of this statement.

TENNESSEE HOUSING DEVELOPMENT AGENCY
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2006, AND JUNE 30, 2005

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Reporting Entity

The Tennessee Housing Development Agency was created by an act of the legislature (Chapter 241, Public Acts, 1973). The act was approved by the Governor on May 14, 1973. The enabling legislation can be found in *Tennessee Code Annotated*, Section 13-23-101 *et seq.* The purpose of the agency is to improve housing and living conditions for lower- and moderate-income persons and families in Tennessee by making loans and mortgages to qualified sponsors, builders, developers, and purchasers of low- and moderate-income family dwellings.

The Agency is governed by a board of directors. The Comptroller of the Treasury, the Secretary of State, the State Treasurer, the Commissioner of the Department of Finance and Administration, and a Staff Assistant to the Governor serve as *ex officio* board members of the Agency. The remaining members are appointed by the Governor, the Speaker of the State Senate and the Speaker of the State House of Representatives. Board members are to be representatives of the housing, real estate, and home building industries, the mortgage profession, local governments, and the three grand divisions of the state and be knowledgeable about the problems of inadequate housing conditions in Tennessee. One member of the board is a resident board member as required by Section 505 of the Quality Housing and Work Responsibility Act of 1998 and 24 CFR Part 964, Subpart E.

In order to accomplish its objectives, the agency is authorized to raise funds through the issuance of bonds and notes. Bonds and notes issued by the agency are not general obligations of the State of Tennessee or any of its political subdivisions, and neither the faith and credit nor the taxing power of the state or any political subdivision is pledged for payment of the principal or interest on such bonds or notes.

The Tennessee Housing Development Agency is a component unit of the State of Tennessee. Although the agency is a separate legal entity, the state appoints a majority of its governing body, approves its operating budget, and provides some financial support. The agency is discretely presented in the *Tennessee Comprehensive Annual Financial Report*.

b. Basis of Presentation

The accompanying financial statements have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). The Agency generally follows private-sector standards of accounting and financial reporting issued prior to December 1, 1989, to the extent that these standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. The Agency also has the option of following subsequent private-sector guidance subject to this same limitation. The Agency has elected not to follow subsequent private-sector guidance. Certain accounting policies and procedures are stipulated in the Agency's Mortgage Finance Program, Single Family Program, and Homeownership Program bond resolutions and the Single Family Mortgage Notes trust indenture. The agency follows these procedures in establishing and maintaining the various funds and accounts for its programs. Revenues and expenses applicable to each fund and account are recorded therein.

c. Basis of Accounting and Measurement Focus

The accompanying financial statements have been prepared using the accrual basis of accounting and the flow of economic resources measurement focus. Under this basis, revenues are recorded when earned and expenses are recorded when liabilities are incurred.

TENNESSEE HOUSING DEVELOPMENT AGENCY
NOTES TO THE FINANCIAL STATEMENTS (CONT.)
JUNE 30, 2006, AND JUNE 30, 2005

d. Capital Assets

Capital assets, which include furniture and office equipment, are defined by the agency as assets with an initial, individual cost of \$5,000 or more.

Capital assets are depreciated on a straight-line basis over the following estimated useful lives of the assets.

<u>Description</u>	<u>Estimated Life</u>
Furniture	10 years
Computer equipment	3 years

e. Restricted Assets

Restricted assets are comprised of the Debt Service Reserve Funds. The bond resolutions require the agency to establish a Debt Service Reserve Fund for each bond issue. The bond resolutions require that if the Debt Service and Expense Funds or the Revenue Funds of a bond issue are not sufficient to provide for interest or principal and sinking fund requirements of that issue that funds be transferred from the Debt Service Reserve Fund to cover any deficiency.

f. Bond Issuance Costs, Refunding Costs, and Interest Accretion

1. **Bond Issuance Costs:** The agency amortizes bond issuance costs using the interest method over the life of the related bond issue. Unamortized bond issuance costs are reported as deferred charges.
2. **Bond and Note Refunding Costs:** The agency amortizes bond and note refunding costs using the straight-line method. Bonds and notes payable are reported net of the deferred amount on refundings.
3. **Bond Premiums and Discounts:** Bond premiums and discounts are deferred and amortized over the life of the bonds using the interest method. Bonds payable are reported net of the applicable unamortized bond premium or discount.
4. **Interest Accretion:** The difference between the face amount of deep discount bonds and the public offering price is not treated as bond discount. Deep discount bonds are subject to redemption at prices which increase from the public offering price up to the face amount. The carrying amount of these bonds is adjusted monthly to reflect the increased liability, with a corresponding charge to interest expense.
5. **Mortgage Discount:** Discounts on 30-year mortgage loans purchased by the agency are amortized using the straight-line method over 17 years, the estimated average life of mortgages. The amount amortized is credited to interest income.

g. Cash and Cash Equivalents

In addition to demand deposits, petty cash, and deposits in the pooled investment fund administered by the State Treasurer, this classification includes short-term investments with original maturities of three months or less from the date of acquisition.

TENNESSEE HOUSING DEVELOPMENT AGENCY
NOTES TO THE FINANCIAL STATEMENTS (CONT.)
JUNE 30, 2006, AND JUNE 30, 2005

h. Investments

The agency has established guidelines for its funds to meet the requirements of the bond resolutions and to comply with the statutes of the State of Tennessee. Permitted investments include the following: direct obligations of the U.S. Treasury and U.S. Agencies; obligations guaranteed by the U.S.; public housing bonds secured by contracts with the U.S.; direct and general obligations of the State of Tennessee or obligations guaranteed by the State of Tennessee; obligations of other states or instrumentalities thereof which are rated in either of the two highest rating categories by Moody's Investor Service or Standard & Poor's Corporation; interest bearing time or demand deposits; collateralized certificates of deposit in authorized state depositories; and repurchase agreements collateralized by authorized securities.

Investments are stated at fair value.

i. Accrual of Interest Income

Interest on first mortgage loans receivable and investment securities is credited to income as earned and classified as interest receivable.

j. Mortgages

Mortgages are carried at their original amount less principal collected.

k. Operating Revenues and Expenses

The agency was created with the authority to issue bonds to the investing public in order to create a flow of private capital through the agency into mortgage loans to certain qualified individuals and qualified housing sponsors. The agency's primary operation is to borrow funds in the bond market and issue those funds to make single-family and multi-family loans. The primary operating revenue is the interest income on outstanding mortgages and the investment income from proceeds of bonds. The primary operating expense of the agency is the interest expense on bonds outstanding.

l. Direct Servicing

On May 1, 2003, the agency began a pilot program called Direct Servicing for servicing mortgages originated by the agency. On March 17, 2005, the agency's Board of Directors voted to terminate the pilot program. The loans were sold to U. S. Bank, one of the agency's existing servicers, on July 1, 2005.

NOTE 2. DEPOSITS AND INVESTMENTS

a. Deposits

Custodial Credit Risk. Custodial credit risk for deposits is the risk that in the event of a bank failure, the agency's deposits may not be returned to it.

The laws of the State of Tennessee require that collateral be pledged to secure all uninsured deposits. The agency's bond resolutions require deposits to be fully secured.

The agency's deposits are in financial institutions which participate in the bank collateral pool administered by the State Treasurer. The securities pledged to protect these accounts are pledged in the aggregate rather than against each individual account. The members of the pool may be required by agreement to pay an assessment to cover any deficiency. Under this additional

TENNESSEE HOUSING DEVELOPMENT AGENCY
NOTES TO THE FINANCIAL STATEMENTS (CONT.)
JUNE 30, 2006, AND JUNE 30, 2005

assessment agreement, public fund accounts covered by the pool are considered to be insured for purposes of credit risk disclosure.

At June 30, 2006, the bank balance was \$2,805,343. At June 30, 2005, the bank balance was \$2,683,008. All bank balances were insured. The carrying amount of cash on deposit in the State Treasurer's pooled investment fund was \$2,262,490 on June 30, 2005. The State Treasurer's pooled investment fund is not rated by a nationally recognized statistical rating organization. The fund's investment policy and required disclosures are presented in the *Tennessee Comprehensive Annual Financial Report*. That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298, or by calling (615) 741-2140.

b. Investments

As stated in the Agency's investment policy, the "prudent man rule" shall be the standard of prudence used by all officials responsible for the investment of Agency assets. Investments are made as a prudent person would be expected to act in the management of their own affairs. That would be to consider the safety of capital and the probability of income, while avoiding speculative investments.

The agency's investment policy states that the agency portfolios will be diversified in order to reduce the risk of loss resulting from over concentration of assets in a specific maturity, a specific issuer, or a specific class of securities. The agency may invest one hundred percent (100%) of its portfolio in U.S. government securities due to the absence of credit risk. A minimum of five percent (5%) of the par value of total investments must mature within five years. No more than fifty percent (50%) of the par value of the combined portfolios can be invested in maturities greater than fifteen (15) years without approval of the Bond Finance Committee.

Portfolio maturities shall be staggered in a way that avoids undue concentrations of assets in a specific maturity sector. Maturities shall be selected which provide for stability of income and reasonable liquidity. It is the intent of this policy that sufficient investments be scheduled to mature to provide for the required liquidity for debt service and other expenditures per resolution requirements.

Interest Rate Risk. Interest Rate Risk is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment.

Duration is a measure of a debt investment's exposure to fair value changes arising from changing interest rates. It uses the present value of cash flows, weighted for those cash flows as a percentage of the investment's full price.

TENNESSEE HOUSING DEVELOPMENT AGENCY
NOTES TO THE FINANCIAL STATEMENTS (CONT.)
JUNE 30, 2006, AND JUNE 30, 2005

Investment Type	June 30, 2006		June 30, 2005	
	Fair Value	Effective Duration (Years)	Fair Value	Effective Duration (Years)
U.S. Agency Coupon	\$252,827,347	4.131	\$232,415,639	4.944
U.S. Agency Discount	311,386,743	.027	78,542,489	0.389
U.S. Treasury Coupon	101,308,523	7.126	112,160,524	7.820
U.S Treasury Discount	0	NA	236,024,519	0.035
Municipal Securities	406,864	2.387	413,255	3.274
Variable Rate Securities	3,469,190	0.624	3,464,290	0.019
Repurchase Agreements	89,000,000	0.005	91,000,000	0.000
Municipal Discount Bonds	0	NA	500,000	0.000
Pass Through Securities	0	NA	1,277,526	4.397
Total	\$758,398,667	2.242	\$755,798,242	2.480

The portfolios include the following investments (stated at par or face value) that have fair values highly sensitive to interest rate changes. These investments are recorded at fair value in the statement of net assets.

Collateralized Mortgage Obligations. The agency purchased \$1,400,000 face value, mortgage-backed pass through securities on January 31, 2005, at .8125003 over par. The fair value of these securities on June 30, 2005, was \$1,277,526. These securities were scheduled to mature on April 15, 2015; however, on January 15, 2006 all payments and interest were received liquidating this investment. These securities are based on cash flows from interest payments on underlying mortgages. Therefore, they are sensitive to prepayments by mortgagees, which may result from a decline in interest rates.

Variable Rate Bonds.

The agency invested \$2,000,000 in range bonds issued by Federal Home Loan Bank. They were purchased at 95.125 of par on August 8, 2003, and mature August 6, 2015. The fair value of these securities on June 30, 2006, is \$1,936,800 and on June 30, 2005, was \$1,925,600 which is included in U.S. Agency Coupon in the table above. The amount of the quarterly interest payments is calculated based on the six month London Interbank Offered Rate (LIBOR) rate. If the LIBOR rate does not exceed 6.625%, then the interest rate on the bond is 6.50%. If the LIBOR rate exceeds 6.625%, then the interest rate is 0.00%. The LIBOR rate can be reset daily on each New York and London banking day, and is closely watched if the LIBOR rate approaches 6.625%. At June 30, 2006, the six-month LIBOR rate was 5.59%, and at June 29, 2005, the rate was 3.69%. At no time during fiscal years 2006 and 2005 did the LIBOR rate exceed 6.625%.

The agency invested \$500,000 in range bonds issued by Federal Home Loan Bank. They were purchased at 99.80 of par on August 24, 2004, and mature August 24, 2009. The fair value of these securities on June 30, 2006, is \$457,450 and on June 30, 2005, was \$477,500 which is included in U.S. Agency Coupon in the table above. The amount of the quarterly interest payments is calculated based on the six month London Interbank Offered Rate (LIBOR) rate. If the LIBOR rate does not exceed 5.00%, then the interest rate on the bond is 5.00% effective until August 24, 2007. Then the interest rate is 5.00% if the LIBOR rate does not exceed 6.00%. If the LIBOR rate exceeds 5.00% or 6.00% respectively, then the interest rate is 0.00%. The LIBOR rate can be reset daily on each New York and London banking day, and is closely watched if the LIBOR rate approaches 5.00% currently. On March 3, 2006, the six-month LIBOR rate was 5.00% and it gradually increased during the remainder of the fiscal year to 5.59% on June 30, 2006.

TENNESSEE HOUSING DEVELOPMENT AGENCY
NOTES TO THE FINANCIAL STATEMENTS (CONT.)
JUNE 30, 2006, AND JUNE 30, 2005

The agency invested \$1,500,000 in range bonds issued by Federal Home Loan Bank. They were purchased at 99.75 of par on September 27, 2005, and mature March 27, 2009. The fair value of these securities on June 30, 2006, is \$1,352,850 which is included in U.S. Agency Coupon in the table above. The amount of the quarterly interest payments is calculated based on the three month London Interbank Offered Rate (LIBOR) rate. If the LIBOR rate does not exceed 5.00%, then the interest rate on the bond is 6.00%. If the LIBOR rate exceeds 5.00% then the interest rate is 0.00%. The LIBOR rate can be reset daily on each New York and London banking day, and is closely watched if the LIBOR rate approaches 5.00%. On March 31, 2006, the three-month LIBOR rate was 5.00% and it gradually increased during the remainder of the fiscal year to 5.48% on June 30, 2006.

The agency also invested \$3,475,000 in variable rate bonds issued by Federal Home Loan Bank. It was purchased at 99.975 of par on February 22, 2005, and matures February 22, 2007. The fair value of these securities on June 30, 2006, is \$3,469,190 and on June 30, 2005, was \$3,464,290. The amount of the quarterly interest payment is calculated at Constant Maturing Treasury (CMT) minus a 0.40% spread. The CMT is reset quarterly on the interest payment dates.

Credit Risk. Credit Risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Refer to Note 1.h for further explanation of the agency's permitted investments. Credit quality ratings for the agency's investments as of June 30, 2006 and June 30, 2005 are included in the schedules below. Securities are rated using Standard and Poor's and / or Moody's and are presented below using the Standard and Poor's rating scale. Funds held in a money market mutual fund were rated AAAm by Standard and Poor's.

		June 30, 2006					
Investment Type	Fair Value	U.S. Treasury / Agency ¹	Credit Quality Rating				
			AAA	AA	A-1+ ²	AA-	Not Rated ³
U.S. Agency Coupon	\$252,827,347		\$240,088,740			\$5,045,547	\$7,693,060
U.S. Agency Discount	311,386,743				\$311,386,743		
U.S. Treasury Coupon	101,308,523	\$101,308,523					
Municipal Securities	406,864			\$406,864			
Variable Rate Securities	3,469,190		3,469,190				
Repurchase Agreements	89,000,000		22,000,000				67,000,000
Total	\$758,398,667	\$101,308,523	\$265,557,930	\$406,864	\$311,386,743	\$5,045,547	\$74,693,060

¹ Includes obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government and are not considered to have credit risk.

² A-1+ is the highest rating category for short-term debt.

³ Includes securities that are implicitly guaranteed by the U.S. government, but are not rated by Standard & Poor's or Moody's.

TENNESSEE HOUSING DEVELOPMENT AGENCY
NOTES TO THE FINANCIAL STATEMENTS (CONT.)
JUNE 30, 2006, AND JUNE 30, 2005

		June 30, 2005					
Investment Type	Fair Value	U.S. Treasury / Agency ¹	Credit Quality Rating				
			AAA	AA	A-1+ ²	AA-	Not Rated ³
U.S. Agency Coupon	\$232,415,639		\$219,033,801			\$5,679,063	\$7,702,775
U.S. Agency Discount	78,542,489		2,099,327		\$76,443,162		
U.S. Treasury Coupon	112,160,524	\$112,160,524					
U.S. Treasury Discount	236,024,519	236,024,519					
Municipal Securities	413,255			\$413,255			
Variable Rate Securities	3,464,290		3,464,290				
Repurchase Agreements	91,000,000						91,000,000
Municipal Discount Bonds	500,000			500,000			
Pass Through Securities	1,277,526						1,277,526
Total	\$755,798,242	\$348,185,043	\$224,597,418	\$913,255	\$76,443,162	\$5,679,063	\$99,980,301

Concentration of Credit Risk. Concentration of credit risk is the risk of loss attributed to the magnitude of the agency's investment in a single issuer.

More than five percent of the agency's investments are invested in the following single issuers:

Issuer	June 30, 2006		June 30, 2005	
	Fair Value	% of Portfolio	Fair Value	% of Portfolio
Federal Home Loan Bank	\$385,099,779	50.78	\$169,383,650	22.41
Federal Home Loan Mortgage Corp	\$62,034,048	08.18	\$68,909,191	09.12
Federal National Mortgage Assoc	\$101,271,612	13.35	\$56,697,282	07.50
Repurchase Agreements – U.S. Agency	\$89,000,000	11.74	\$91,000,000	12.04

NOTE 3. CHECKS / WARRANTS / WIRES PAYABLE

This amount includes the sum of checks written in excess of the agency's checking account balance because of the agency's use of a controlled disbursement account. Through the use of a controlled disbursement account, the agency maximizes interest income by transferring from an investment account only funds necessary to cover the checks that clear the bank daily. This amount also includes the sum of warrants and wires initiated by the agency at year-end in excess of the agency's balance in the State Pooled Investment Fund that have not completely processed through the banking system. These warrants and wires are for grant payments for the Section 8 grant programs and will be reimbursed by the U. S. Department of Housing and Urban Development.

¹ Includes obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government and are not considered to have credit risk.

² A-1+ is the highest rating category for short-term debt.

³ Includes securities that are implicitly guaranteed by the U.S. government, but are not rated by Standard & Poor's or Moody's.

TENNESSEE HOUSING DEVELOPMENT AGENCY
NOTES TO THE FINANCIAL STATEMENTS (CONT.)
JUNE 30, 2006, AND JUNE 30, 2005

NOTE 4. LIABILITIES

a. Bonds Issued and Outstanding

BONDS ISSUED AND OUTSTANDING					
(Thousands)					
<u>Series</u>	<u>Maturity Range</u>	<u>Issued Amount</u>	<u>Interest Rate (Percent)</u>	<u>Ending Balance 06/30/2006</u>	<u>Ending Balance 6/30/2005</u>
<u>MORTGAGE FINANCE PROGRAM BONDS</u>					
1994B	7/1/96-7/1/2025	\$100,000	4.50 to 6.60	\$ -0-	\$ 1,645
1995B/C	1/1/97-7/1/2026	100,000	4.80 to 6.55	4,990	8,605
2003A	7/1/2004-7/1/2034	191,885	1.70 to 5.35	167,475	182,690
Total Mortgage Finance Program Bonds		<u>\$391,885</u>		172,465	192,940
Less: Deferred Amount on Refundings				(3,411)	(3,720)
Net Mortgage Finance Program Bonds				<u>\$ 169,054</u>	<u>\$ 189,220</u>
<u>HOMEOWNERSHIP PROGRAM BONDS</u>					
Issue K	7/1/92-7/1/2021	\$74,775	6.4 to 8.125	\$ -0-	\$ 1
			Interest accretion	-0-	3
1995-1	1/1/97-7/1/2026	65,000	4.35 to 6.48	4,345	5,780
1996-1	7/1/97-1/1/2026	40,000	4.00 to 5.85	13,135	15,790
1996-2	1/1/98-7/1/2027	65,000	4.40 to 6.375	17,710	23,030
1996-3	7/1/99-7/1/2028	65,000	4.30 to 6.00	17,405	20,115
1996-4	7/1/98-7/1/2027	55,000	4.35 to 6.45	10,180	14,060
1996-5	7/1/99-7/1/2028	60,000	3.85 to 5.75	29,565	33,520
1997-1	7/1/99-7/1/2028	57,885	4.00 to 5.40	27,735	31,245
1997-2	7/1/2000-7/1/2029	50,000	3.20 to 5.20	23,270	27,095
1997-3	1/1/98-7/1/2017	88,008	4.00 to 5.85	16,176	24,184
			Interest accretion	9,295	11,836
1998-1	7/1/2001-7/1/2030	50,000	3.95 to 5.40	22,400	26,630
1998-2	7/1/2000-7/1/2029	30,000	4.00 to 5.375	11,130	13,590
1998-3	7/1/2000-7/1/2031	80,000	3.70 to 6.15	30,255	36,860
1999-1	7/1/2001-7/1/2031	41,000	3.95 to 6.25	14,135	17,305
1999-2	7/1/2001-7/1/2031	150,000	4.25 to 5.70	38,085	45,500
1999-3	7/1/2001-7/1/2031	110,000	4.30 to 6.15	36,850	43,535
2000-1	7/1/2001-7/1/2031	105,000	4.60 to 6.40	20,535	29,240
2000-2	7/1/2001-7/1/2031	110,000	5.00 to 7.93	51,900	63,370
2001-1	7/1/2001-7/1/2032	135,390	3.41 to 5.65	79,855	85,195
2001-2	1/1/2003-7/1/2032	60,000	3.10 to 5.375	37,030	43,395
2001-3	1/1/2003-7/1/2032	64,580	2.85 to 5.45	38,295	45,385
2002-1	7/1/2003-7/1/2033	85,000	1.85 to 5.45	53,910	62,050
2002-2	1/1/2004-7/1/2033	85,000	2.25 to 5.40	62,970	70,535
2003-1	7/1/2004-7/1/2033	50,000	1.20 to 5.10	41,585	46,325
2003-2	7/1/2004-1/1/2034	60,000	1.10 to 4.40	52,555	57,300
2003-3	7/1/2004-7/1/2034	75,000	1.20 to 5.00	66,165	71,155
2004-1	1/1/2005-1/1/2035	80,000	1.30 to 5.00	73,560	78,075
2004-2	7/1/2005-1/1/2035	100,000	1.85 to 5.25	95,185	100,000
2004-3	1/1/2006-7/1/2035	100,000	2.55 to 5.125	95,910	100,000
2005-1	7/1/2006-1/1/2036	100,000	2.75 to 5.00	100,000	-0-
2005-2	1/1/2007-7/1/2036	100,000	3.00 to 5.00	100,000	-0-
2006-1	7/1/2007-1/1/2037	100,000	3.55 to 5.75	100,000	-0-
Total Homeownership Program Bonds		<u>\$2,491,638</u>		\$ 1,391,126	\$ 1,242,104
Plus: Unamortized Bond Premiums				14,139	8,689
Less: Deferred Amount on Refundings				(5,847)	(6,583)
Net Homeownership Program Bonds				<u>1,399,418</u>	<u>1,244,210</u>
Net Total All Issues				<u>\$ 1,568,472</u>	<u>\$ 1,433,430</u>

TENNESSEE HOUSING DEVELOPMENT AGENCY
NOTES TO THE FINANCIAL STATEMENTS (CONT.)
JUNE 30, 2006, AND JUNE 30, 2005

b. Debt Service Requirements

Debt service requirements to maturity at June 30, 2006 are as follows (expressed in thousands):

For the Year(s) Ending			Total
<u>June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Requirements</u>
2007	\$105,865	\$77,598	\$183,463
2008	52,425	75,605	128,030
2009	48,651	69,991	118,642
2010	47,845	66,800	114,645
2011	48,450	64,620	113,070
2012 – 2016	196,411	292,324	488,735
2017 – 2021	135,831	253,469	389,300
2022 – 2026	226,131	212,593	438,724
2027 – 2031	169,426	160,645	330,071
2032 – 2036	458,215	94,142	552,357
2037	79,185	2,587	81,772
Total	<u>\$1,568,435</u>	<u>\$1,370,374</u>	<u>\$2,938,809</u>

The debt principal in the preceding table is \$37,000 less than that presented in the accompanying financial statements. Of this amount, \$9,295,000 represents the accretion to date of interest on deep discount bonds in those years preceding the first principal payment on these bonds. This accretion has been reported as bond principal in the financial statements; it has been reported above as interest in those years (2007-2009) in which the bonds mature. Also, \$9,258,000, which is a deduction from bonds payable for the deferred amount on refundings, is not reflected in the above presentation.

c. Redemption of Bonds and Notes

During the year ended June 30, 2006, bonds were retired at par before maturity in the Mortgage Finance Program in the amount of \$7,265,000 and in the Homeownership Program in the amount of \$71,880,000. The respective carrying values of the bonds were \$7,191,410 and \$71,630,120. This resulted in an expense to the Mortgage Finance Program of \$73,590 and the Homeownership Program of \$249,880.

On July 1, 2005, a third drawdown was made on the Series 2004 CN-1 Notes in the amount of \$34,620,000. These proceeds were used to refund bonds previously issued in the Mortgage Finance Program and the Homeownership Program (this amount consists of \$16,185,000 early redemption and \$18,435,000 current maturities). The carrying amount of these bonds was \$34,595,966. The refunding resulted in a difference of \$24,034 between the reacquisition price and the net carrying amount of the old debt. A portion of these notes were refunded with bonds on December 8, 2005 and after year-end.

On July 28, 2005, the agency issued \$100,000,000 in Homeownership Bonds, Issue 2005-1. On August 11, 2005, the agency used \$28,740,000 of these bonds to partially refund the convertible drawdown notes, 2002 CN-1, which were used July 1, 2003, November 3, 2003, January 2, 2004, and July 1, 2004, to refund certain bonds previously issued in the Mortgage Finance and Homeownership programs. The refunding increased the agency's debt service by \$4,403,524 over the next 26.5 years, and the agency realized an economic gain (the difference between the present values of the old and new debt service payments) of \$2,603,550.

TENNESSEE HOUSING DEVELOPMENT AGENCY
NOTES TO THE FINANCIAL STATEMENTS (CONT.)
JUNE 30, 2006, AND JUNE 30, 2005

On November 17, 2005, the agency issued \$100,000,000 in Homeownership Bonds, Issue 2005-2. On December 8, 2005, the agency used \$39,630,000 of these bonds to partially refund the convertible drawdown notes, 2002 CN-1, which were used January 2, 2003, July 1, 2003, and April 1, 2004 to refund certain bonds previously issued in the Mortgage Finance and Homeownership programs. The agency also used \$12,685,000 of these bonds to partially refund the convertible drawdown notes, 2004 CN-1, which were used October 1, 2004, January 3, 2005, and July 1, 2005, to refund certain bonds previously issued in the Mortgage Finance and Homeownership programs. The refunding reduced the agency's debt service by \$11,380,279 over the next 27.5 years, and the agency realized an economic gain (the difference between the present values of the old and new debt service payments) of \$7,375,779.

On December 8, 2005, a fourth drawdown was made on the Series 2004 CN-1 Notes in the amount of \$203,835,000. Of these proceeds, \$167,225,000 was used to refund 2002 CN-1 Notes at maturity. Also, \$36,610,000 of these proceeds were used on January 1, 2006, to refund bonds previously issued in the Mortgage Finance and Homeownership programs (\$24,685,000 early redemption and \$11,925,000 current maturities). The carrying amount of these bonds was \$36,669,782. The refunding resulted in a difference of \$59,782 between the reacquisition price and the net carrying amount of the old debt. Because notes were used to refund long-term bonds, neither the change in debt service nor the economic gain or loss disclosures are appropriate.

On April 27, 2006, the agency issued \$100,000,000 in Homeownership Bonds, Issue 2006-1. On May 11, 2006, the agency used \$39,680,000 of these bonds to partially refund the convertible drawdown notes, 2004 CN-1, which were used October 1, 2004 and January 3, 2005 to refund certain bonds previously issued in the Mortgage Finance and Homeownership programs. The refunding reduced the agency's debt service by \$4,091,138 over the next 28 years, and the agency realized an economic gain (the difference between the present values of the old and new debt service payments) of \$1,596,587.

During the year ended June 30, 2005, bonds were retired at par before maturity in the Mortgage Finance Program in the amount of \$12,320,000 and in the Homeownership Program in the amount of \$86,406,071. The respective carrying values of the bonds were \$12,255,060 and \$85,858,454. This resulted in an expense to the Mortgage Finance Program of \$64,940 and the Homeownership Program of \$547,617.

On July 1, 2004, the agency used \$39,185,000 of Single Family Mortgage Program notes, 2002CN-1, to refund bonds previously issued in the Mortgage Finance Program and the Homeownership Program (this amount consists of \$27,955,000 early redemption and \$11,230,000 current maturities). The carrying amount of these bonds was \$38,994,680. The refunding resulted in a difference of \$190,320 between the reacquisition price and the net carrying amount of the old debt. Because notes were used to refund long-term bonds, neither the change in debt service nor the economic gain or loss disclosures are appropriate.

On July 15, 2004, the agency issued \$100,000,000 in Homeownership Program Bonds, Issue 2004-2. On August 1, 2004, the agency used \$7,835,000 of these bonds to refund bonds previously issued in the Homeownership Program (this amount consists of \$7,835,000 early redemption and \$0 current maturities). The carrying amount of these bonds was \$7,760,168. The refunding resulted in a difference of \$74,832 between the reacquisition price and the net carrying amount of the old debt. This difference, reported in the accompanying financial statements as a deduction from bonds payable, is being charged to operations through the year 2020. On August 12, 2004, the agency used \$43,920,000 of these bonds to partially refund the convertible drawdown notes, 2002 CN-1, which were used July 1, 2003 to refund certain bonds previously issued in the Mortgage Finance and Homeownership programs. The refunding

TENNESSEE HOUSING DEVELOPMENT AGENCY
NOTES TO THE FINANCIAL STATEMENTS (CONT.)
JUNE 30, 2006, AND JUNE 30, 2005

reduced the agency's debt service by \$16,960,633 over the next 26 years, and the agency realized an economic gain (the difference between the present values of the old and new debt service payments) of \$12,082,652.

On October 1, 2004, the agency used \$34,145,000 of Single Family Mortgage Program Notes, 2004CN-1, drawn down on August 31, 2004, to refund bonds previously issued in the Mortgage Finance Program and the Homeownership Program (this amount consists of \$34,145,000 early redemption and \$0 current maturities). The carrying amount of these bonds was \$33,943,005. The refunding resulted in a difference of \$201,995 between the reacquisition price and the net carrying amount of the old debt. Because notes were used to refund long-term bonds, neither the change in debt service nor the economic gain or loss disclosures are appropriate.

On January 3, 2005, the second drawdown was made on the Series 2004CN-1 Notes in the amount of \$42,160,000. These proceeds were used to refund bonds previously issued in the Mortgage Finance and Homeownership programs (\$28,685,000 early redemption and \$13,475,000 current maturities). The carrying amount of these bonds was \$41,996,549. The refunding resulted in a difference of \$163,451 between the reacquisition price and the net carrying amount of the old debt. Because notes were used to refund long-term bonds, neither the change in debt service nor the economic gain or loss disclosures are appropriate.

On January 13, 2005, a principal redemption was made on the Series 2002CN-1 Notes in the amount of \$32,910,000.

On January 13, 2005, the agency issued \$100,000,000 in Homeownership Program Bonds, Issue 2004-3. The agency used \$32,910,000 of these bonds to partially refund the convertible drawdown notes, 2002CN-1, which were used July 1, 2003, to refund certain bonds previously issued in the Mortgage Finance and Homeownership programs. On March 1, 2005, all outstanding Y1Z1 and Y2Z2 Series bonds in the amount of \$18,175,000 were called. Of this amount, \$700,000 were called at par and the Optional Redemption provision was used to call the remaining \$17,475,000 bonds at 101 percent. Mortgage prepayments and excess reserves were used to call \$1,175,000 of the bonds. The remaining \$17,000,000 was refunded by 2004-3. The carrying amount of these bonds was \$16,913,790. A call premium of \$165,150 was paid on the redemption of these bonds. The refunding resulted in a difference of \$251,360 between the reacquisition price and the net carrying amount of the old debt. This difference, reported in the accompanying financial statements as a deduction from bonds payable, is being charged to operations through the year 2016. The refunding increased the agency's debt service by \$586,997 over the next 26 years, but the agency realized an economic gain (the difference between the present values of the old and new debt service payments) of \$7,701,042.

TENNESSEE HOUSING DEVELOPMENT AGENCY
NOTES TO THE FINANCIAL STATEMENTS (CONT.)
JUNE 30, 2006, AND JUNE 30, 2005

d. Long-term Liability Activity

The following table is a summary of the long-term liability activity for the year ended June 30, 2006.

Long-term Liabilities					
(Thousands)					
	Beginning Balance			Ending Balance	Amounts Due Within
	<u>July 1, 2005</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2006</u>	<u>One Year</u>
Notes Payable	\$311,900	\$238,455	(\$287,960)	\$262,395	\$-0-
Bonds Payable	1,435,044	301,441	(172,894)	1,563,591	111,525
Plus: Unamortized Bond Premiums	8,689	6,515	(1,065)	14,139	-0-
Less: Deferred Amount on Refundings	(10,303)	(42)	1,087	(9,258)	-0-
Compensated Absences	639	59	(116)	582	285
Escrow Deposits	15,360	3,723	(3,759)	15,324	969
Arbitrage Rebate Payable	2,687	2,027	(3,866)	848	-0-
Deferred Revenue	259	132	(172)	219	-0-
Total	\$1,764,275	\$552,250	(\$468,745)	\$1,847,780	\$112,779

The following table is a summary of the long-term liability activity for the year ended June 30, 2005.

Long-term Liabilities					
(Thousands)					
	Beginning Balance			Ending Balance	Amounts Due Within
	<u>July 1, 2004</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2005</u>	<u>One Year</u>
Notes Payable	\$273,240	\$115,490	(\$76,830)	\$311,900	\$235,595
Bonds Payable	1,495,513	201,957	(262,426)	1,435,044	78,730
Plus: Unamortized Bond Premiums	4,655	4,534	(500)	8,689	-0-
Less: Deferred Amount on Refundings	(10,869)	(690)	1,256	(10,303)	-0-
Compensated Absences	572	496	(429)	639	313
Escrow Deposits	15,206	5,006	(4,852)	15,360	1,485
Arbitrage Rebate Payable	6,110	128	(3,551)	2,687	-0-
Deferred Revenue	347	108	(196)	259	-0-
Total	\$1,784,774	\$327,029	(\$347,528)	\$1,764,275	\$316,123

e. Notes Issued and Outstanding

The Single Family Mortgage Notes Trust Indenture, dated December 1, 1997 (the "Trust Indenture"), provided for the issuance of agency drawdown notes with a maximum aggregate principal amount of \$65,000,000. On April 1, 1999, the Trust Indenture was supplemented providing for the maximum aggregate principal amount to be \$200,000,000. On December 1, 2002, the Trust Indenture was supplemented providing for the maximum aggregate principal amount to be \$450,000,000.

The notes bear interest, payable on the second Thursday of each succeeding month with respect to the principal amount drawn down by the agency. The interest rate is equal to ninety-nine percent (99%) of the bond equivalent yield as determined on the related rate date.

TENNESSEE HOUSING DEVELOPMENT AGENCY
NOTES TO THE FINANCIAL STATEMENTS (CONT.)
JUNE 30, 2006, AND JUNE 30, 2005

The following table is a summary of the note activity for the year ended June 30, 2006.

NOTES ISSUED AND OUTSTANDING							
(Thousands)							
Series	Maturity	Stated Principal	Interest Rate (Percent)	Beginning Balance 7/01/2005	Additions	Reductions	Ending Balance 6/30/2006
<u>SINGLE FAMILY MORTGAGE NOTES</u>							
2002CN-1	12/8/2005	\$ 450,000	2.753 to 3.853	\$235,595	\$-0-	(\$235,595)	\$-0-
2004CN-1	8/9/2007	\$ 450,000	2.990 to 4.983	76,305	238,455	(52,365)	262,395
Total Single Family Mortgage Notes				\$311,900	\$238,455	(\$287,960)	\$262,395

The following table is a summary of the note activity for the year ended June 30, 2005.

NOTES ISSUED AND OUTSTANDING							
(Thousands)							
Series	Maturity	Stated Principal	Interest Rate (Percent)	Beginning Balance 7/01/2004	Additions	Reductions	Ending Balance 6/30/2005
<u>SINGLE FAMILY MORTGAGE NOTES</u>							
2002CN-1	12/8/2005	\$ 450,000	1.010 to 2.753	\$273,240	\$39,185	(\$76,830)	\$235,595
2004CN-1	8/9/2007	\$ 450,000	1.466 to 2.990	-0-	76,305	(-0-)	76,305
Total Single Family Mortgage Notes				\$273,240	\$115,490	(\$76,830)	\$311,900

The activity of the 2002CN-1 and 2004CN-1 notes shown above is also included in the summary of long-term liability activity in part d. of this note.

NOTE 5. RESTRICTED NET ASSETS

The amount shown on the Statement of Net Assets as Restricted for Single Family Bond Programs is contractually pledged, under the bond resolutions of the agency, to the owners of the bonds issued under such bond resolutions. As pledged assets, the contractual provisions of the bond resolutions restrict the use of such assets. However, the assets may be removed from the lien of the bond resolutions if certain parity tests, as established by the respective bond resolutions, are satisfied. Assets removed from the lien of the respective bond resolutions may be used for other purposes.

The amount shown as Restricted for Grant Programs represents unexpended grant money that has been awarded to grantees through various grant programs administered by the agency.

The amount shown as Restricted for Homebuyers Revolving Loan Program represents the amount of net assets that are restricted for a pilot program that funds zero interest loans for down payment and closing costs. The use of these net assets is restricted under legislation enacted in fiscal year 1986.

NOTE 6. DEFINED BENEFIT PENSION PLAN

The agency contributes to the State Employees, Teachers, and Higher Education Employees Pension Plan (SETHEEPP), a cost-sharing, multiple-employer defined benefit pension plan administered by the Tennessee Consolidated Retirement System (TCRS). TCRS provides retirement, death, and disability benefits as well as annual cost-of-living adjustments to plan members and their beneficiaries. Title 8, Chapters 34-37, *Tennessee Code Annotated*, establishes benefit provisions. State statutes are amended by the Tennessee General Assembly.

TENNESSEE HOUSING DEVELOPMENT AGENCY
NOTES TO THE FINANCIAL STATEMENTS (CONT.)
JUNE 30, 2006, AND JUNE 30, 2005

The TCRS issues a publicly available financial report that includes financial statements and required supplementary information for SETHEPP. That report may be obtained by writing to the Tennessee Department of the Treasury, Consolidated Retirement System, 10th Floor Andrew Jackson Building, Nashville, Tennessee, 37243-0230 or by calling (615) 741-8202.

Plan members are noncontributory. The agency is required to contribute at an actuarially determined rate. The current rate is 10.30% of annual covered payroll. Contribution requirements for the agency are established and may be amended by the TCRS' Board of Trustees. The agency's contributions to TCRS for the years ended June 30, 2006, 2005, and 2004, were \$771,350, \$753,275, and \$480,912. Those contributions met the required contributions for each year.

NOTE 7. PROVISIONS FOR MORTGAGE LOAN LOSSES

Most mortgage loans are insured by the Federal Housing Administration (FHA) or an approved private mortgage insurance company, or are guaranteed by the Department of Veterans Affairs. The agency's Board of Directors has designated \$750,000 of unrestricted net assets as a provision for possible loan losses arising from participation in the Rural Economic and Community Development (RECD) Loan Guarantee Program. An additional \$232,000 was designated to provide for losses on loans not specifically covered under one of the above programs, and \$500,000 has been designated for self-insurance of second mortgages.

NOTE 8. RISK MANAGEMENT

a. Commercial Insurance

The agency carries commercial insurance for risks of loss related to employee dishonesty; general liability protection; and theft of, damage to, or destruction of real and personal property. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

b. Risk Management Fund

The state has set aside assets for claim settlement in an internal service fund, the Risk Management Fund. This fund services all claims for risk of loss to which the state is exposed, including general liability, automobile liability, professional malpractice, and workers' compensation. The agency participates in the Risk Management Fund. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the agency based on a percentage of the agency's expected loss costs which include both experience and exposures. This charge considers recent trends in actual claims experience of the state as a whole. An actuarial valuation is performed as of each fiscal year-end to determine the fund liability and premium allocation. Since the agency participates in the Risk Management Fund, it is subject to the liability limitations under the provisions of the Tennessee Claims Commission Act, *Tennessee Code Annotated*, Section 9-8-101 et seq. Liability for negligence of the agency for bodily injury and property damage is limited to \$300,000 per person and \$1,000,000 per occurrence. The limits of liability under workers' compensation are set forth in *Tennessee Code Annotated*, Section 50-6-101 et seq. Claims are paid through the state's Risk Management Fund.

c. Employee Group Insurance Fund

The state has also set aside assets in the Employee Group Insurance Fund, an internal service fund, to provide a program of health insurance coverage for the employees of the state with the risk retained by the state. The agency participates in the Employee Group Insurance Fund. The

TENNESSEE HOUSING DEVELOPMENT AGENCY
NOTES TO THE FINANCIAL STATEMENTS (CONT.)
JUNE 30, 2006, AND JUNE 30, 2005

fund allocates the cost of providing claims servicing and claims payment by charging a premium to the agency based on estimates of the ultimate cost of claims that have been reported but not settled and of claims that have been incurred but not reported. Employees and providers have 13 months to file medical claims.

NOTE 9. OTHER POST-EMPLOYMENT BENEFITS

The State of Tennessee provides and administers a group health insurance program which provides post-employment health insurance benefits to eligible agency retirees. The agency assumes no liability for retiree health care programs. Information related to this plan is available at the statewide level in the *Tennessee Comprehensive Annual Financial Report*.

NOTE 10. PAYMENTS TO PRIMARY GOVERNMENT

From time to time, the State of Tennessee has called upon the agency and its resources, together with resources of other departments, agencies and organizations in state government, to provide funds to the State General Fund to balance the State budget. The following is a description of these occurrences in relationship to the agency. On June 30, 1995, \$15,000,000 from the agency's Housing Program Reserve Fund was transferred to the State General Fund. On June 30, 1998, \$43,000,000 was transferred from the agency to the State General Fund. The \$43,000,000 transferred from the agency came from the following resources of the agency: (i) \$15,459,157 from tax revenues previously directed to the Housing Program Fund; (ii) \$5,028,761 from the Housing Program Reserve Fund; and (iii) \$22,512,082 from the Assets Fund. On June 30, 2002, a transfer from the agency to the primary government in the amount of \$35,367,449 was made from the Assets Fund for the sole purpose of meeting the requirements of funding the operations of the primary government for the year ended June 30, 2002.

NOTE 11. SUBSEQUENT EVENTS

- a. Mortgage prepayments and foreclosure proceeds were used to redeem bonds as indicated below:

July 1, 2006	Mortgage Finance Program	\$ 4,095,000
	Homeownership Program	<u>\$49,215,000</u>
	Total	<u>\$53,310,000</u>

- b. Homeownership Program Bonds, Issue 2006-2, were sold on July 27, 2006. The bond maturities are as follows:

BONDS ISSUED			
(Thousands)			
Series	Maturity Range	Issued Amount	Interest Rate (Percent)
2006-2	7/1/2007-1/1/2037	<u>\$100,000</u>	3.90 to 5.75
TOTAL ALL ISSUES		<u>\$100,000</u>	

On September 14, 2006, the agency used \$46,605,000 of these bonds to partially refund the convertible drawdown notes, 2004 CN-1, which were used January 3, 2005, and July 1, 2005, to refund certain bonds previously issued in the Mortgage Finance and Homeownership programs.

TENNESSEE HOUSING DEVELOPMENT AGENCY
SUPPLEMENTARY INFORMATION
SUPPLEMENTARY SCHEDULE OF NET ASSETS
JUNE 30, 2006
(Expressed in Thousands)

	Operating Group	Mortgage Finance Program	Home- ownership Program Bonds	Single Family Mortgage Notes	Totals
ASSETS					
Current assets:					
Cash and cash equivalents	\$ -	\$ 28,102	\$ 133,122	\$ 263,392	\$ 424,616
Investments	-	13,701	20,669	-	34,370
Receivables:					
Accounts	-	2,957	7,474	-	10,431
Interest	-	2,528	9,084	-	11,612
First mortgage loans	75	7,598	26,596	-	34,269
Due from federal government	10,318	-	-	-	10,318
Due from other funds	-	44	-	-	44
Total current assets	10,393	54,930	196,945	263,392	525,660
Noncurrent assets:					
Restricted assets:					
Cash and cash equivalents	-	20	154	-	174
Investments	-	38,324	138,069	-	176,393
Investment Interest receivable	-	556	1,919	-	2,475
Investments	-	73,158	99,091	-	172,249
First mortgage loans receivable	267	165,664	1,270,593	-	1,436,524
Deferred charges	23	1,010	8,599	1,987	11,619
Advance to local government	2,812	-	-	-	2,812
Other receivables	-	-	10	-	10
Capital assets:					
Furniture and equipment	153	-	-	-	153
Less accumulated depreciation	(93)	-	-	-	(93)
Total noncurrent assets	3,162	278,732	1,518,435	1,987	1,802,316
Total assets	13,555	333,662	1,715,380	265,379	2,327,976
LIABILITIES					
Current liabilities:					
Checks / warrants / wires payable	3,037	6	2,812	-	5,855
Accounts payable	1,098	26	59	-	1,183
Accrued payroll and related liabilities	323	-	-	-	323
Compensated absences	285	-	-	-	285
Due to primary government	84	-	-	-	84
Interest payable	-	4,011	33,082	824	37,917
Escrow deposits	-	969	-	-	969
Prepayments on mortgage loans	-	113	1,266	-	1,379
Due to other funds	-	-	44	-	44
Bonds payable	-	15,770	95,755	-	111,525
Total current liabilities	4,827	20,895	133,018	824	159,564
Noncurrent liabilities:					
Notes payable	-	-	-	262,395	262,395
Bonds payable	-	153,284	1,303,663	-	1,456,947
Compensated absences	297	-	-	-	297
Escrow deposits	298	14,057	-	-	14,355
Arbitrage rebate payable	-	-	848	-	848
Deferred revenue	-	219	-	-	219
Total noncurrent liabilities	595	167,560	1,304,511	262,395	1,735,061
Total liabilities	5,422	188,455	1,437,529	263,219	1,894,625
NET ASSETS					
Invested in capital assets	60	-	-	-	60
Restricted for single family bond programs	-	145,207	277,851	2,160	425,218
Restricted for grant programs	385	-	-	-	385
Restricted for Homebuyers Revolving Loan Program	3,154	-	-	-	3,154
Unrestricted	4,534	-	-	-	4,534
Total net assets	\$ 8,133	\$ 145,207	\$ 277,851	\$ 2,160	\$ 433,351

TENNESSEE HOUSING DEVELOPMENT AGENCY
SUPPLEMENTARY INFORMATION
SUPPLEMENTARY SCHEDULE OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2006
(Expressed in Thousands)

	Operating Group	Mortgage Finance Program	Home- ownership Program Bonds	Single Family Mortgage Notes	Totals
OPERATING REVENUES					
Mortgage interest income	\$ -	\$ 11,975	\$ 75,143	\$ -	\$ 87,118
Investment income:					
Interest	351	6,003	17,271	1	23,626
Net increase (decrease) in the fair value of investments	-	(6,220)	(15,736)	12,354	(9,602)
Federal grant administration fees	9,903	-	-	-	9,903
Fees and other income	1,851	1,220	122	-	3,193
Total operating revenues	12,105	12,978	76,800	12,355	114,238
OPERATING EXPENSES					
Salaries and benefits	10,121	-	-	-	10,121
Contractual services	1,766	-	-	-	1,766
Materials and supplies	425	-	-	-	425
Rentals and insurance	1,083	-	-	-	1,083
Other administrative expenses	453	-	-	-	453
Other program expenses	10	808	1,638	91	2,547
Interest expense	-	8,528	65,648	12,390	86,566
Mortgage service fees	-	610	4,553	-	5,163
Issuance costs	-	77	434	16	527
Depreciation	17	-	-	-	17
Total operating expenses	13,875	10,023	72,273	12,497	108,668
Operating income (loss)	(1,770)	2,955	4,527	(142)	5,570
NONOPERATING REVENUES (EXPENSES)					
Federal grants revenue	162,137	-	-	-	162,137
Federal grants expenses	(162,137)	-	-	-	(162,137)
Local grants expenses	(1,004)	(40)	(3,699)	-	(4,743)
Total nonoperating revenues (expenses)	(1,004)	(40)	(3,699)	-	(4,743)
Income (loss) before transfers	(2,774)	2,915	828	(142)	827
Transfers (to) other funds	(33)	(1,383)	-	(61)	(1,477)
Transfers from other funds	-	-	1,477	-	1,477
Change in net assets	(2,807)	1,532	2,305	(203)	827
Total net assets, July 1	10,940	143,675	275,546	2,363	432,524
Total net assets, June 30	\$ 8,133	\$ 145,207	\$ 277,851	\$ 2,160	\$ 433,351

TENNESSEE HOUSING DEVELOPMENT AGENCY
SUPPLEMENTARY INFORMATION
SUPPLEMENTARY SCHEDULE OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2006
(Expressed in Thousands)

	Operating Group	Mortgage Finance Program	Home- ownership Program Bonds	Single Family Mortgage Notes	Totals
Cash flows from operating activities:					
Receipts from customers	\$ (407)	\$ 45,087	\$ 248,386	\$ -	\$ 293,066
Receipts from federal government	5,502	-	-	-	5,502
Receipts from other funds	-	-	44	-	44
Other miscellaneous receipts	1,851	1,220	122	-	3,193
Acquisition of mortgage loans	-	-	(283,007)	-	(283,007)
Payments to service mortgages	-	(610)	(4,553)	-	(5,163)
Payments to suppliers	(3,177)	(745)	(1,386)	(3)	(5,311)
Payments to federal government	-	-	(1,839)	(88)	(1,927)
Payments to other funds	-	(44)	-	-	(44)
Payments to employees	(10,455)	-	-	-	(10,455)
Net cash provided (used) by operating activities	(6,686)	44,908	(42,233)	(91)	(4,102)
Cash flows from non-capital financing activities:					
Operating grants received	163,509	-	-	-	163,509
Transfers in (out)	(33)	(1,374)	1,389	18	-
Negative cash balance implicitly financed	2,971	(497)	1,642	(25)	4,091
Proceeds from sale of bonds	-	-	306,515	-	306,515
Proceeds from issuance of notes	-	-	-	238,455	238,455
Operating grants paid	(162,890)	(40)	(3,699)	-	(166,629)
Call premium paid	-	-	-	-	-
Cost of issuance paid	-	-	(2,267)	(16)	(2,283)
Principal payments	-	(20,475)	(152,419)	(287,960)	(460,854)
Interest paid	-	(8,620)	(61,119)	(11,871)	(81,610)
Net cash provided (used) by non-capital financing activities	3,557	(31,006)	90,042	(61,399)	1,194
Cash flows from capital and related financing activities:					
Purchases of capital assets	(60)	-	-	-	(60)
Net cash used by capital and related financing activities	(60)	-	-	-	(60)
Cash flows from investing activities:					
Proceeds from sales and maturities of investments	-	34,714	67,913	-	102,627
Purchases of investments	-	(51,861)	(103,595)	-	(155,456)
Investment interest received	351	5,906	17,389	12,355	36,001
Net cash provided (used) by investing activities	351	(11,241)	(18,293)	12,355	(16,828)
Net increase (decrease) in cash and cash equivalents	(2,838)	2,661	29,516	(49,135)	(19,796)
Cash and cash equivalents, July 1	2,838	25,461	103,760	312,527	444,586
Cash and cash equivalents, June 30	\$ -	\$ 28,122	\$ 133,276	\$ 263,392	\$ 424,790

(continued)

TENNESSEE HOUSING DEVELOPMENT AGENCY
SUPPLEMENTARY INFORMATION
SUPPLEMENTARY SCHEDULE OF CASH FLOWS (cont.)
FOR THE YEAR ENDED JUNE 30, 2006
(Expressed in Thousands)

	<u>Operating Group</u>	<u>Mortgage Finance Program</u>	<u>Home- ownership Program Bonds</u>	<u>Single Family Mortgage Notes</u>	<u>Totals</u>
Reconciliation of operating income to net cash provided (used) by operating activities:					
Operating income (loss)	\$ (1,770)	\$ 2,955	\$ 4,527	\$ (142)	\$ 5,570
Adjustments to reconcile operating income to net cash provided (used) by operating activities:					
Depreciation and amortization	17	77	434	16	544
Changes in assets and liabilities:					
(Increase) decrease in accounts receivable	-	(1,326)	2,949	-	1,623
Decrease in mortgage interest receivable	-	339	117	-	456
(Increase) decrease in first mortgage loans receivable	(1)	33,794	(112,967)	-	(79,174)
(Increase) in due from federal government	(4,401)	-	-	-	(4,401)
Decrease in deferred charges	4	74	249	-	327
(Increase) in interfund receivables	-	(44)	-	-	(44)
Increase in interfund payables	-	-	44	-	44
Increase (decrease) in accounts payable	(212)	334	140	-	262
(Decrease) in accrued payroll / compensated absences	(13)	-	-	-	(13)
Increase in due to primary government	41	-	-	-	41
(Decrease) in deferred revenue	-	(40)	-	-	(40)
(Decrease) in arbitrage rebate liability	-	-	(1,839)	-	(1,839)
Investment (income) loss included as operating revenue	(351)	217	(1,535)	(12,355)	(14,024)
Interest expense included as operating expense	-	8,528	65,648	12,390	86,566
Total adjustments	<u>(4,916)</u>	<u>41,953</u>	<u>(46,760)</u>	<u>51</u>	<u>(9,672)</u>
Net cash provided (used) by operating activities	\$ <u>(6,686)</u>	\$ <u>44,908</u>	\$ <u>(42,233)</u>	\$ <u>(91)</u>	\$ <u>(4,102)</u>
Noncash investing, capital, and financing activities:					
Accretion of deep discount bonds	\$ -	\$ -	\$ 1,442	\$ -	\$ 1,442
Increase (decrease) in fair value of investments	-	(6,306)	(16,042)	898	(21,450)
Total noncash investing, capital, and financing activities	\$ <u>-</u>	\$ <u>(6,306)</u>	\$ <u>(14,600)</u>	\$ <u>898</u>	\$ <u>(20,008)</u>

TENNESSEE HOUSING DEVELOPMENT AGENCY
SUPPLEMENTARY INFORMATION
SUPPLEMENTARY SCHEDULE OF NET ASSETS - MORTGAGE FINANCE PROGRAM
JUNE 30, 2006
(Expressed in Thousands)

	Mortgage Finance Bond	General Fund	Mortgage Finance Bond Group Total*	Escrow Fund**	Mortgage Finance Program Total
ASSETS					
Current assets:					
Cash and cash equivalents	\$ 19,885	\$ 6,946	\$ 26,831	\$ 1,271	\$ 28,102
Investments	12,960	-	12,960	741	13,701
Receivables:					
Accounts	2,957	-	2,957	-	2,957
Interest	1,936	464	2,400	128	2,528
First mortgage loans	7,178	420	7,598	-	7,598
Due from other funds	4	40	44	-	44
Total current assets	<u>44,920</u>	<u>7,870</u>	<u>52,790</u>	<u>2,140</u>	<u>54,930</u>
Noncurrent assets:					
Restricted assets:					
Cash and cash equivalents	20	-	20	-	20
Investments	38,324	-	38,324	-	38,324
Investment interest receivable	556	-	556	-	556
Investments	40,372	21,948	62,320	10,838	73,158
First mortgage loans receivable	161,036	4,628	165,664	-	165,664
Deferred charges	1,010	-	1,010	-	1,010
Total noncurrent assets	<u>241,318</u>	<u>26,576</u>	<u>267,894</u>	<u>10,838</u>	<u>278,732</u>
Total assets	<u>286,238</u>	<u>34,446</u>	<u>320,684</u>	<u>12,978</u>	<u>333,662</u>
LIABILITIES					
Current liabilities:					
Checks / warrants / wires payable	-	-	-	6	6
Accounts payable	8	18	26	-	26
Interest payable	4,011	-	4,011	-	4,011
Escrow deposits	-	-	-	969	969
Prepayments on mortgage loans	110	3	113	-	113
Bonds payable	15,770	-	15,770	-	15,770
Total current liabilities	<u>19,899</u>	<u>21</u>	<u>19,920</u>	<u>975</u>	<u>20,895</u>
Noncurrent liabilities:					
Bonds payable	153,284	-	153,284	-	153,284
Escrow deposits	-	1,915	1,915	12,142	14,057
Deferred revenue	-	219	219	-	219
Total noncurrent liabilities	<u>153,284</u>	<u>2,134</u>	<u>155,418</u>	<u>12,142</u>	<u>167,560</u>
Total liabilities	<u>173,183</u>	<u>2,155</u>	<u>175,338</u>	<u>13,117</u>	<u>188,455</u>
NET ASSETS					
Restricted for single family bond programs	<u>113,055</u>	<u>32,291</u>	<u>145,346</u>	<u>(139)</u>	<u>145,207</u>
Total net assets	<u>\$ 113,055</u>	<u>\$ 32,291</u>	<u>\$ 145,346</u>	<u>\$ (139)</u>	<u>\$ 145,207</u>

* The Mortgage Finance Bond Group Total represents the funds pledged to the Mortgage Finance Program Resolution.

** The Escrow Funds can only be used for escrow payments.